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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1982

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ARIZONA GOVERNING COMMITTEE FOR TAX DEFERRED ANNUITY AND DEFERRED COMPENSATION PLANS, STATE OF ARIZONA, *et al.*,

v. *Petitioners,*

NATHALIE NORRIS, on behalf of herself and all others similarly situated,

*Respondents.*

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**On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit**

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## BRIEF OF AMERICAN ACADEMY OF ACTUARIES AS AMICUS CURIAE

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## BRIEF OF AMERICAN ACADEMY OF ACTUARIES AS AMICUS CURIAE

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Consent to the filing of this brief has been given by counsel for both sides. Letters to this effect have been filed with the Clerk.

### INTEREST OF THE AMICUS

The American Academy of Actuaries (the "Academy") is a national accrediting organization for the actuarial profession. It was formed in 1965 by three existing national actuarial organizations—the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, and the Society of Actuaries. The Academy and these three founding organizations or their predecessors have represented the actuarial profession in the United States

for over 90 years. The Academy currently has over 7,000 members.

The actuarial profession plays a central role in the design and administration of employee retirement plans.[1] We are, accordingly, in the unique position of being able to offer the Court information about the structure of such plans and to describe the potential effect of this Court's decision on the various types of plans.

## INTRODUCTION AND SUMMARY: THE OBJECTIVE AND STRUCTURE OF THIS BRIEF

In *City of Los Angeles* v. *Manhart*, 435 U.S. 702 (1978), this Court held that the contributory defined benefit pension plan of the City of Los Angeles violated Section 703(a)(1) of Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-2(a)(1). That plan was unusual in that it required women to contribute, during their working years, larger amounts than were required of similarly situated men. The Academy filed a brief *amicus curiae* in that case that urged neither affirmance nor reversal. We represented to the Court that a decision that the City's plan violated Title VII would not have a widespread effect if it were limited to the particular kinds of provisions then before the Court. An affirmance in the case now before the Court, however, would have major impact on a great variety of plans currently in use.

Since *Manhart*, there have been five decisions by Courts of Appeals dealing with these other types of plans.[2] All

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[1] Over 85% of those persons who have qualified as "enrolled actuaries" under the Employee Retirement Income Security Act of 1974 (ERISA) are members of the Academy. That Act provides, for defined benefit pension plans, that an enrolled actuary must submit an annual statement which reports on critical financial information about the plan.

[2] We take the liberty of omitting citations that will be readily available in the many briefs that will be filed in this action.

but one has concluded that a retirement plan that provides for lifetime benefit payments in unequal monthly amounts to similarly situated men and women violates Title VII. Without regard to the correctness of these decisions, they reflect a less than complete understanding of the nature of the several types of retirement programs and of the ramifications of the decisions. These plans have strikingly different characteristics that may be relevant to deciding how Title VII should be applied in the context of employee retirement plans.

Part I of this brief, accordingly, describes the major types of retirement plans and the distinctions that are made between men and women in the administration of these plans. It concludes with a description of the features of the plan at issue here that we regard as material.[3]

Under one major type of plan, if benefits in the form of lifetime monthly payments are to be provided, they are virtually always provided by the purchase of annuities from an insurance company. Insurers, in fixing the prices of these annuities, and of insurance products generally, employ procedures known as the pooling and classification of risks. Part II of this brief describes why actuaries take account of the fact that women as a class live longer than men as a class in connection with these procedures.

In Part III we examine several ways in which Section 703(a) of Title VII might be applied to the provision of lifetime benefits under employee retirement plans. We set out briefly the arguments that have been advanced in favor of and against each of these interpretations. We describe the impact that the adoption of each of these

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[3] Regrettably, many of these plans are complex, and any summary description is subject to the infirmity that it is necessarily incomplete. Although running the risk of making statements that may not always be wholly accurate, we have omitted factual detail or qualifying comment where irrelevant to the issues in this case.

interpretations would have on the employers, actuaries, and insurance companies that administer these plans and on the employees and retirees covered by them.

Finally, in Part IV we consider the relief that has been granted by the courts below in this and some other cases.

## ARGUMENT

### I. DESCRIPTION OF THE MAJOR TYPES OF RETIREMENT PLANS

Congress has sought to encourage private employers to sponsor retirement plans for their employees and particularly plans that provide benefits in the form of periodic payments that continue as long as the employee lives.[4]

Women as a class live longer than men as a class. The difference is significant and is not decreasing.[5] Accordingly, it costs more to provide life incomes or annuities to women than it does to provide similar benefits to men who retire at the same age. Quite different accommodations have been made to this fact under different types of plans.

#### A. Defined Benefit Plans

In a defined benefit plan, the principal undertaking on the part of the employer is to pay a specified benefit to the employee upon retirement. Although the employee cannot determine in advance the precise number of dol-

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[4] For example, for non-governmental plans "qualified" under § 401 of the Internal Revenue Code, contributions made in a given year by an employer are deductible from the employer's income but are not includible in the taxable income of employees until distributed as benefits.

[5] The life expectancy of a woman born in 1920 was 54.6 years. A man born the same year had a life expectancy of 53.6 years. By contrast, the life expectancy of a woman born in 1979 was 77.8 years, compared to 69.9 years for a man born in that year. 1981 STATISTICAL ABSTRACT OF THE UNITED STATES at 69.

lars he or she will receive, the formula by which that amount will be determined is set forth in advance.[6]

Because the benefit to be received is the focus of these plans, contributions made by the employer are generally not segregated into individual employee accounts. The amount of these contributions is based upon an actuarial valuation of how much money must be contributed during the working years of the employees covered by the plan in order to fund the promised benefits. It is not particularly meaningful, therefore, to ask what amount is being contributed on behalf of a particular employee, or what amount is being contributed on behalf of women as opposed to men. However, the actuary will take into account the individual characteristics of employees, such as age and sex, in advising the employer what his contribution should be to fund the promised benefits.[7]

Virtually all defined benefit plans provide for a "normal" retirement age and for a "normal" benefit in the form of monthly payments for the life of the employee that are identical for similarly situated men and women. Plans subject to ERISA are required to provide the option of a joint and survivor pension that will continue until the deaths of the employee and his or her spouse and that will automatically be provided in the absence of a contrary election by the employee. Many plans also give employees the option to retire earlier or later than the normal retirement age.

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[6] A plan might provide, for example, that the annual pension will equal 2 percent of the sum of the employee's total earnings; or a similar percentage of the employee's final year's earnings multiplied by the number of years of employment.

[7] The accumulated contributions plus the earnings thereon are held for the sole benefit of the employees. The amount of the pension received by the employees is not a function of the rate of earnings, however. Rather, the amount of the pension is simply a function of the formula referred to above. A higher rate of earnings results in reducing the employer's cost, not increasing the employee's benefits.

If an optional benefit is elected, many plans provide for an adjustment of the amount of the monthly payment. The amount of the adjustment is frequently determined with the objective of making the cost of the optional benefit approximately equal to the cost of the normal benefit. For this reason, if a joint and survivor pension is elected, the amount of the adjustment depends, among other things, upon whether the retiring employee is a man or a woman. Similarly, early or late retirement may result in different adjustments for men and women, as was the case in *Retired Public Employees* v. *State of California*, 677 F.2d 733 (9th Cir. 1982), *petition for cert. filed Aug. 14, 1982*, 51 U.S.L.W. 3212 (Sept. 28, 1982) (No. 82-262). The difference results when the greater longevity of women is taken into account in determining the optional benefit.[8]

Under a defined benefit plan, while the contributions made by the employer each year are intended to provide adequately for the promised benefits, the amount contributed is an estimate based upon an anticipated rate of earnings, employee turnover, mortality rates, inflation, and other factors. The ultimate cost to the employer is uncertain.[9]

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[8] In addition to the optional benefits described above, some defined benefit plans provide a number of additional forms in which benefits can be taken. These include (a) a life income or annuity paying a monthly amount for as long as the employee lives but with payments guaranteed for a minimum period (e.g., 10 years) even if the employee dies before the end of that period; (b) monthly payments over a stated number of years irrespective of when the employee dies; and (c) a lump sum option.

[9] This uncertainty in the past has been more acceptable to larger corporate employers. Smaller corporations and partnerships have turned to defined contribution plans to give them better control over what the cost of their pension plan will be. Recently some larger employers have sought to change from defined benefit to defined contribution plans in order to achieve better control over pension costs. See, *e.g.*, BUSINESS WEEK, November 8, 1982 at 85.

### B. Defined Contribution Plans

Defined contribution plans specify the amount of the contributions made by the employer rather than the level of benefits to be provided to the employee upon retirement.

Contributions are made and accounts are maintained on behalf of each individual employee. It is very rare for a defined contribution plan to provide that different contributions will be made for male and female employees who are otherwise similarly situated.[10] At the time of retirement, therefore, a man and a woman with identical years of employment and salary histories, whose accounts have been invested in the same way, will have accumulated identical amounts in individual accounts.

These plans often provide for the payment of the accumulated amount to the employee in a lump sum. They also generally provide for lifetime monthly payments. In the latter case payments are almost always provided through the purchase, by the plan administrator, of an annuity from an insurance company. Since insurance companies recognize that women live longer than men, they provide smaller periodic payments to women than to men for the same accumulated amount.

### C. The Plan at Issue in this Case

The plan at issue in this case is a type of defined contribution plan, known as a deferred compensation plan. It offers the employees of the State the option, on a strictly voluntary basis, of deferring the receipt of a portion of their compensation. Each participating employee designates the amount by which his or her current salary will be reduced. Each employee then desig-

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[10] Retirement plans may or may not be "contributory" and provide for employee contributions in addition to those of the employer.

nates which of the funding media selected by the State (including an insurance company, a mutual fund, and a credit union) will invest the deferred compensation. In order to secure the tax advantages which are the principal motivation for the plan, however, the funds remain assets of the State and are subject to the claims of the State's general creditors.[11]

When an employee reaches retirement age, the amount credited to his or her account may be withdrawn in full as a lump sum. If the employee prefers to have a lifetime annuity, the insurance company designated under the plan will assume the contractual obligation to make the annuity payments. Alternatively, the employee may elect a lump sum and purchase an annuity from some other insurance company, but if that is done the employee forgoes part of the tax advantage that results from the plan.[12]

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[11] Deferred compensation plans such as this one offer significant tax advantages to the employee. The amounts deferred are not subject to tax at the time of deferral, so that the full pre-tax amount of this compensation can be invested in the funding medium (i.e. $200 pre-tax per month rather than $140 for a person in the 30% bracket). Because the funds are still technically the funds of the State, the earnings on these deferred amounts are not taxed at the time they are earned. When the employee retires and receives his or her benefits under the plan, these amounts (including both the compensation deferred and the earnings thereon) are taxable to the employee—but often at rates that are lower than the rates applicable to the employee's income during his or her working years.

[12] If an employee has had his or her account held in the mutual fund, for example, and the funds are transferred to the insurance company at retirement, they are still not deemed to have been received by the employee and the employee is taxed on the monthly annuity payments as received. If the funds are transferred to an insurance company not designated under the plan, however, the funds are deemed to have been received by the employee at that point and are taxable in full.

This plan is not the State's retirement plan for its employees. The role of the State in the administration of this plan is a very limited one. It selects, at the outset, funding media for the plan. It reduces each employee's salary to the desired level and transfers the difference to the particular funding medium the employee has designated. But it is barred by statute from contributing any money to the plan on its employees' behalf. The State was thus not in a position to accept the financial uncertainty of funding life annuities. It had no general funds available in the event its particular employees happened to live longer than the mortality tables predicted. As a consequence, the only way the officials responsible for the plan could comply with the authorizing statute and offer this benefit was by transferring the risk to an insurance company by the purchase of annuity contracts.

The next section of this brief describes how an insurance company is able to accept this risk.

## II. THE POOLING AND CLASSIFICATION OF RISKS

The risk that the insurance company accepts when it undertakes to write life annuities arises because it is impossible to predict in advance how long any single individual will live. But if this risk is assumed with respect to a group of persons, the rate and frequency of deaths within that group can be reliably predicted based on the past mortality experience of similar groups. This permits the insurer to set the amount of monthly annuity as members of the group retire at a level that will not exhaust the total fund available for the payment of annuities until the last person in the pool has died.

Although the insurer must in this way substitute the predictability of the group for the uncertainty surrounding the life span of the individual, the focus on the individual is not lost. Through the process of risk classification, the insurer evaluates the likelihood that a particular individual will have greater longevity than the average. This is accomplished by evaluating the

specific characteristics of the individual which correlate statistically with longevity. The two most common in connection with annuities are sex and age.

There are two important reasons for this practice.

First, it is a principle of long standing in the insurance context that fairness and equity are achieved when individuals are classified according to the likelihood that they will experience the risk being insured. Under this view, fairness and equity are achieved when each individual under an employer-sponsored retirement plan receives benefits that are "actuarially equivalent" to the benefits received by others. In the present context, the monthly amount paid to a woman is lower than that paid to a similarly situated man. The difference is in an amount that will make equal in value the two income streams, which differ in duration because of the greater longevity of women.

Second, risk classification is essential to the successful operation—to the financial soundness—of an insurance arrangement. Where people have the right to decide whether or not to purchase insurance or to accept a life annuity, the similar treatment of persons with different risk characteristics would invite low-risk persons to decline coverage or to decline the annuity in favor of alternatives which provide them benefits more commensurate with the risk they represent. A frequently cited example of the danger of ignoring this "adverse selection" phenomenon is found in the experiences of the early "burial societies." These societies paid a benefit upon the death of one of their members out of premiums and assessments that were set without regard to the age of the individual member. As the average age of the members increased, and mortality experience worsened, the frequency of assessments increased and the established associations were unable to attract the younger members necessary to keep down the level of payments. Ultimately, these insurance mechanisms collapsed, leaving many mem-

bers without the protection for which they had contributed over a number of years.

Another consequence of requiring by law that an identical premium be charged or an equal periodic benefit be paid for groups involving different risks is that it creates incentives that may not be desirable. Insurers that are more successful in attracting the low risk group will realize greater profit. They may seek to do this, for example, by focusing their advertising so as to reach primarily members of the low-risk group. Market pressures may also discourage other companies from assuming the higher risks at all, with a resultant narrowing of the breadth of insurance coverage that is available to persons in the high risk group.

The extent to which adverse selection is a significant factor varies considerably depending upon the type of insurance that is offered and the existence of other factors that affect the choice of the persons in the insured group. It does not operate at all if there is no choice. If the individuals in a group of insureds do have an election but it is not one that they are likely to exercise, then the problem posed by adverse selection may not be significant. In general, however, experience has shown that where an opportunity for adverse selection is provided, a substantial number of persons may take advantage of that opportunity.

## III. INTERPRETATION AND APPLICATION OF SECTION 703(a) OF TITLE VII

### A. An Actuarial Perspective on the Theories Advanced on this Issue

We offer here, in summary fashion, brief comment from an actuarial perspective on several issues that have been raised in this and related cases.

In *Manhart* the fact that a woman received a lower take-home pay than a similarly situated man was regarded as unlawful discrimination on the basis of sex.

A much more difficult question is whether a non-contributory defined contribution plan—or a contributory plan where equal contributions are required of similarly situated men and women (so that take-home pay is equal)—would violate Title VII if the monthly lifetime payments received by women were smaller than those received by men.

Those who would answer this question in the affirmative argue that a monthly payment of $90 cannot be regarded under any circumstances as equal to a monthly payment of $100. Those who would answer the question in the negative argue that the compensation to the employee, whether viewed at the time of retirement or, during the employee's working years, as incremental additions to each wage payment, is the right to receive a stream of monthly payments that will continue until he or she dies. This stream of payments has a present or discounted value which, in situations where it is necessary, can be and is ascertained.[13] Such income streams are, of course, bought and sold in the market as annuities and, when they are, a given purchase price will buy a stream of level monthly payments that are lower for a woman than for a man. The two streams of payments are actuarially equivalent in value, however, and that is why they cost the same amount. That is also why, the argument runs, men and women should be regarded as receiving equal compensation.

A number of different responses are made to this argument.

1. *Sex as a predictor of longevity.* It is contended by some that sex is not a reliable basis for predicting future longevity. Although conceding that in the past women as a class have lived longer than men, they assert that this difference will disappear as women engage in

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[13] It is done, for example, for tax purposes. See, e.g., Treas. Reg. § 20.2031-10(b) (1970), 26 C.F.R. § 20.2031-10(b) (1982).

more hazardous occupations and share more widely with men habits such as smoking.

The available evidence does not support this contention. Women have made greater gains in longevity over this past century than have men.[14] A recent U.S. census report projects that those gains will continue through the first half of the 21st century notwithstanding the report's assumption that women will increasingly enter the work force during this period.[15]

2. *The availability of other indicia of longevity.* A second argument urges that actuarial equivalence that is based upon classification by sex should be rejected as a measure of equality because it does not consider other factors, in addition to age and sex, that are known to correlate with longevity—smoking habits, departures from normal weight, the longevity of parents and grandparents, etc. At best, these persons argue, actuarial equivalence based on sex is a sham; at worst it is a pretext for discrimination based on sex.

This argument has a superficial appeal. But we think it is wrong. Two classes of persons with observable differences in longevity may be treated as a single class if the relevant differences, though identifiable, are relatively small. The minor "unfairness" involved may be outweighed by the added expense of treating the two cases differently. Small differences do not give rise to significant adverse selection and so are acceptable from a business standpoint. Further, some of the alternative grounds for classification are also fairly difficult to apply. For example, persons who smoke heavily may deny it.

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[14] See *supra* note 5.

[15] Female life expectancy is expected to rise from 78.3 years in 1981 to 83.6 years in the year 2050, while male life expectancy is expected to rise from 70.7 years to only 75.1 over the same period. U.S. BUREAU OF THE CENSUS, POPULATION ESTIMATES AND PROJECTIONS (Series P-25, No. 922, October 1982).

What is more important, however, is that were these other longevity factors employed, sex would continue to be a significant factor in accounting for longevity differences. So far as the available evidence shows, for example, women who smoke live longer than men who smoke.[16] Any insurer who, in fixing the prices for annuities, used these other factors but ignored sex would, in a competitive market, be subject to adverse selection as men sought the more attractive benefits offered by other companies free to take sex into account. If these or other factors provided a superior alternative to sex as a classification, insurers would have every business incentive to employ them.[17]

3. *The Overlap Theory.* Yet another argument that the provision to men and women of benefits that are actuarially equivalent should not satisfy Title VII has come to be called the "overlap theory." It was first advanced by Professors Bergmann and Gray.[18] They point

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[16] The United Nations Demographic Yearbook reports, with limited exceptions, significantly lower mortality rates for women than for men throughout the world, in a wide variety of cultures. UNITED NATIONS DEMOGRAPHIC YEARBOOK 1970, TABLE 20 at 710-729 (1971). Where mortality studies are limited to individuals who work for pay outside the home, the differential between male and female mortality is greater than for individuals who do not. Lautzenheiser, *Sex and the Single Table: Equal Monthly Retirement Income for the Sexes?*, 2 EMPLOYEE BENEFITS JOURNAL 1 (1976). An analysis of data gathered in 1965 in California concluded that after adjusting for 16 risk factors (including occupation, smoking, alcohol use, physical activity, church and group membership, and life satisfaction), male mortality continued to exceed female mortality. In fact, the analysis found that the combined effect of adjusting for all 16 variables was to increase the difference in relative mortality risk for men and women. Wingard, *The Sex Differential in Mortality Rates: Demographic and Behavioral Factors*, 115 AMER. JOURNAL OF EPIDEMIOLOGY 205-16 (1982).

[17] For example, a handful of companies began to classify successfully risks on the basis of smoking habits. Offering lower premiums to non-smokers is now a widely used life insurance practice.

[18] Bergmann & Gray, *Equality in Retirement Benefits: The Need for Pension Reform*, 8 CIV. RTS. DIG. 25 (1975).

out that in a group made up equally of men and women all 65 years of age, say 1000 of each, for about 84 percent—or 840 men and 840 women—the years of their deaths can be matched one for one. However, eighty men will die in the early years of the group unmatched by deaths among the women, and eighty women will die in the later years unmatched by deaths among men. The argument asserts that the use of sex-distinct tables allows the savings in annuity costs for the 8 percent of the group consisting of men who die early to be entirely monopolized by men, while the extra burdens imposed by the 8 percent of the population consisting of women who die later are entirely borne by the women.

The persons who make these assertions conclude that this is inherently unfair and inequitable. The flaw in this contention is that it looks at mortality retrospectively. Purchase rates for annuities, however, must be fixed prospectively. It cannot be determined in advance who will fall into the unmatched long-lived group. The probability that any woman chosen at random will fall into the unmatched long-lived group—to which relatively large aggregate payments will be made—is .16, while the probability that any randomly chosen man will fall into that group is zero. It is equitable, therefore, to charge each woman a higher amount for the same benefit.[19]

These arguments also fail to recognize the financial significance of the important fact that the unmatched male deaths occur early and the unmatched female deaths occur later. For example, in a retirement pool of 1,000 females and 1,000 males, each receiving $10,000 a year for life beginning at age 65, it would take $41 million more to provide the benefit for females than for males.

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[19] The unsoundness of the concept may also be demonstrated by looking at an analogous example. If the deaths of a large group of 60-year-old women were to be matched against the deaths of a group of 65-year-old women, a similar overlap of 80.7 percent would exist. Yet few would argue that it is inherently fair to charge 60-year-old women the same price for life insurance or annuities as is charged 65-year-old women.

The arguments, finally, relate only to the fairness or unfairness of providing actuarial equity. The conclusion drawn by the proponents of this theory, that unisex mortality tables should be employed, ignores the resultant adverse selection discussed at pages 10-11, *supra*, and 18-19, *infra*.

### B. The Probable Impact of the Court's Decision

In Part IV of this brief, we discuss the question of whether the Court's decision, if it is one that makes necessary a change in existing practices, should be retroactive or only prospective. In this section we predict, as best we can, what the practical impact will be on the various types of plans of a Court decision adopting one or another of the various interpretations of Title VII that will be urged upon it. For this purpose we make the assumption that any relief granted by the Court would be prospective in nature and that actuaries would continue to be able to classify prospective insureds by their sex when fixing the prices charged for life insurance and annuities.

Although this case could be reversed on rather narrow grounds, a broader ruling on reversal or on affirmance would almost surely apply *a fortiori* not just to other deferred compensation plans like this one but also to other types of defined contribution plans and possibly to defined benefits plans as well. Therefore, we deem it appropriate to set out for the Court the impact of alternative resolutions on these other kinds of plans.

#### 1. *If equal monthly payments are mandated*

a. *Defined contribution plans.* Plans that provided *only* lifetime pensions could be administered so as to provide equal monthly payments without regard to the sex of the retiring employee and still carry out the employer's original objective of fixing its costs in advance. The amounts accumulated for each retiring employee could be used, as they are today, to purchase annuities. In fixing

the prices for those annuities, actuaries of the insurance companies that chose to continue to participate in this market would have to utilize mortality tables that are appropriate for each particular plan.[20] These would be "unisex" tables in the sense that the monthly benefit derived using the table would be the same for a similarly situated man and woman. But in developing the unisex table for each plan, the actuary would still have to take into account whether the annuitants will be primarily men or primarily women and in what proportions. An undertaking to furnish annuities to an employer whose retiring employees are likely to be made up of 90 percent men and 10 percent women must use a different table than the table that must prudently be used if the employees were 60 percent women and 40 percent men. Thus even a "unisex" table would reflect the differing mortality experience of men and women.

In addition, we would expect with such a plan that the current practice of guaranteeing annuity purchase rates long in advance would likely have to be modified, so that as the composition of each employer's work force changed, mortality tables could be adjusted and the level of monthly payments made to employees retiring after that date modified accordingly.

Plans that offer an election between a lump sum payment and an annuity upon retirement would be harder to handle, because of adverse selection. Sponsors of these plans might respond by eliminating one or the other of the options. Dropping the annuity option would defeat a principal objective of the Congress in granting favorable tax treatment to employer-sponsored pension plans—to encourage employers to provide life annuities as a supplement to Social Security benefits.[21] In the case of de-

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[20] See *infra* pages 18-19 for the reasons that might lead some insurers to withdraw from the market.

[21] Employees are likely to object to the elimination of the lump sum option, which provides them with desirable flexibility.

ferred compensation plans, such as that involved in this case, a substantial tax advantage would be lost if the annuity option were to be dropped.

If both options are retained, an insurance company desiring to continue in this market would have to fix annuity rates that took into account not only the sexual composition of the work force but also the probability that there would be extensive adverse selection. The insurance company chosen by the employer cannot ignore this latter factor because once it begins using unisex tables, men close to retirement can be expected to seek more attractive arrangements by electing the lump sum option and then purchasing from other insurance companies annuities that would be priced using sex-distinct tables. These would of course provide the men with larger monthly payments.

To respond, the actuary for the plan's insurer might well have to use a mortality table that assumed that most of the employees electing annuities under the plan would be women. The result of all this, therefore, might be that retiring women would receive annuities under the plan with monthly amounts that were not materially better than are now provided using existing sex-distinct tables. Men would continue to receive larger benefits but with the additional expense of transferring their lump sum benefit to an insurance company outside the plan.

The impact of mandating equal monthly payments for these plans could be even more far-reaching. Because insurers now use sex in their risk classification process, they need not be concerned about the mix of men and women who purchase annuities from them. An insurer required to use unisex rates, however, must assume the financial risk that the sex distribution of its annuitants will differ materially from that of the mortality table it used for pricing its product and determining benefits. There may be inconsistencies with other state and federal laws and regulations that will be difficult to resolve. More

generally, the prohibition of business practices that have valid economic justification often results in market dislocations that cannot wholly be predicted in advance. Some insurers may choose to withdraw from this market altogether.

b. *Defined benefit plans.* A decision that equal monthly payments are mandated would have little effect upon defined benefit plans so far as the "normal" pension benefit is concerned, since this form of benefit already pays equal monthly amounts to similarly situated men and women. However, if this Court in *Retired Public Employees* v. *State of California*, No. 82-262, *supra*, (petition for certiorari pending) were to decide that equal monthly payments are mandated by Title VII for optional benefits as well, this would prohibit the frequently employed although not universal practice of using sex-distinct annuity tables in computing the amounts payable under those options.

Actuaries would continue to take into consideration the sexual composition of the work force and, in addition, statistical data concerning the extent to which men differ from women in electing the available options. In computing the benefits payable under the options, they would use a mortality table appropriate to the sexual composition of the work force under the particular plan.[22] This would mean that the benefits paid under various plans might differ. To take one example, a 65 year old male or female employee of employer X, whose spouse is also 65, and who is entitled to a normal pension benefit of $1,000 a month, might be entitled to a joint and survivor pension of $875. A similarly situated employee of employer Y with the same $1000 a month normal benefit might be entitled to a joint and survivor pension of $925 per month. But the men and women employed by each employer would be treated identically.

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[22] This would not be possible in plans with few participants. A prudent actuary for such a plan might well feel compelled to anticipate that each employee will elect the most costly option.

For those defined benefit plans which provide a lump sum benefit or for benefits payable for a fixed number of years, the amount of these benefits would prudently have to be set at a level that was the actuarial equivalent of the normal pension for women. If they were set at a higher level the likely result would be that many men would elect the lump sum benefit and purchase annuities from an insurance company, thereby increasing the employer's cost. It can be expected that many employers would prefer to drop these optional forms of benefits.

***2. If actuarial equivalence using sex-based classifications is mandated***

a. *Defined contribution plans.* If the Court were to decide that actuarial equivalence using sex-distinct annuity tables was mandated by Title VII, thereby restricting its decision in *Manhart* to the narrow facts of that case—unequal take-home pay violates Title VII—defined contribution plans could continue to be designed and administered much as they are today. Women electing an annuity option would receive monthly payments lower than those received by men unless and until the difference in the longevity of the two classes disappeared or narrowed considerably.

b. *Defined benefit plans.* A decision that actuarially equivalent pensions are required under defined benefit plans would have serious consequences. At present similarly situated men and women who are covered under defined benefit plans receive normal pensions of identical monthly amounts which are, accordingly, not actuarially equivalent. A decision that women should be given a normal pension that is the actuarial equivalent of the normal pension now given to men would pay them substantially lower benefits than they now expect to receive and might impair contractual rights to such benefits. A decision that men should receive normal pensions that are the actuarial equivalent of the normal pensions now provided to women

would impose very significant new costs upon employers. Either decision is, as a matter of fact, practically precluded because of the inherent structure of a defined benefit plan.[23] Although not an issue in this case, it is an issue that is not far distant from that in *Retired Public Employees*, No. 82-262, *supra*, and we feel obligated to advise the Court of the possible ramifications of an opinion in this case that is phrased without awareness of this possible consequence.

### 3. *If equal contributions by the employer are mandated*

a. *Defined contribution plans.* These plans would be little affected by an interpretation of Title VII that mandated only that the employer's contributions into the plan for similarly situated men and women be equal. Virtually all of these plans already follow this practice.[24]

b. *Defined benefit plans.* An "equal contribution" interpretation of Title VII makes little sense in the context of defined benefit plans since there is no real "contribution" on behalf of any particular employee or group of employees under these plans. The focus of these plans is instead upon the benefits that are payable upon retirement.

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[23] It would either require adopting a benefit formula based upon sex (*e.g.*, 2% of aggregate salary for men and 1.92% of aggregate salary for women) or determining the normal pension benefit for employees of one sex and providing employees of the other sex with the actuarially equivalent normal benefit.

[24] This interpretation would not focus on the payments received by the employee under a life annuity since it is not the employer who provides these payments. Each employee's account is a separate one. For the employer to take the amount credited to a particular employee and give in exchange the employer's promise to make payments for life would, in effect, be entering into the business of insurance. This is exactly what the employer and particularly the smaller employer decides not to do by adopting a defined contribution plan.

### 4. *If different obligations are mandated for different types of plans*

There may be a consideration that is material to the decision of this Court that has largely been ignored in the extensive commentary that has followed the *Manhart* decision. If the issue ultimately comes down to what is "equal" compensation, then one might look at the differing nature of the plans for any guidance it provides on this issue. If this is done, the striking difference between various types of plans may suggest an interpretation of the statute that is somewhat different for each major type of plan.

a. *Defined benefit plans.* As we pointed out in our earlier description, the contributions made by the employer under a defined benefit plan are not made by individual employee or even by groups of employees (*i.e.*, men and women). Consequently, an interpretation of Title VII that focused on the contributions of the employer and tried to determine whether they were nondiscriminatory would be very difficult if not impossible to apply.

An interpretation that looks to the benefits received is more consistent with the structure of defined benefit plans, which focuses on the pension the employee will receive when he or she retires. The interpretation of Title VII, in this context, would seem to call for identical monthly payments, at least for the "normal" pension benefit. Moreover, as *Manhart* has already held, this requirement could not be undercut by requiring unequal contributions from men and women.

The issue is not as clear with respect to the optional benefits under these plans. For larger plans, if identical monthly payments are required, employers could provide desirable optional benefits, thereby increasing the flexibility available to employees under the plan, and could still fix the amount of these benefits so that the employer

would neither incur any substantial additional cost nor save any money as the result of the election. This could be accomplished with the same practices but also the same problems as described at pages 19-20. For smaller plans, where reliable estimates of cost are much harder to make, and for plans which include optional lump sum benefits, requiring identical monthly payments would have a much greater disruptive effect than would be true for larger plans.

b. *Defined contribution plans.* Under these plans, the focus is not upon the benefits that will ultimately be received by the employee. Defined contribution plans are structured around what the employer contributes on a periodic basis during the employee's working years—contributions credited to the employee's own individual account and invested in a manner over which the employee often has considerable control. An interpretation of Title VII that requires that contributions be equal for similarly situated men and women would be consistent with the structure of these plans.[25]

### C. The Plan Before this Court

If the substance rather than the form of the Arizona plan is viewed as controlling, the fact that Arizona is regarded, for purposes of federal income taxation, as the

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[25] The understanding of both employees or employee unions and employers—the parties to the compensation arrangement—as to what constitutes "equal compensation" might also be a consideration that bears upon how Title VII should be interpreted in this context. While there are no studies available and no polls have been taken, it may be a fair inference that men and women covered by a defined benefit plan, who are not knowledgeable about the employer's contributions or the funding mechanism, understand that they will receive identical wages and an identical monthly pension. Employees covered by a defined contribution plan are told about their employer's contributions and know that the identical amounts set aside for men and women will be the source of their benefit. It could be argued that those common understandings support the interpretation described above.

legal owner of the amount of the compensation that is deferred until it is actually received by the employees may be entitled to very little weight. Arizona, before adopting the plan, had agreed to pay its employees certain salaries. Participation in the plan was voluntary. If an employee chose to participate, he or she designated the amount by which his or her salary would be reduced. Arizona did not pay the participating employees one cent of additional compensation. Its contribution was merely to collect the salary reductions, transmit them to the funding media selected by the employee, and keep records. In this context, Arizona might well be regarded as having paid its employees simply the wages to which they were originally entitled plus the costs of administration. Those amounts were provided without discrimination between men and women.

Arizona did offer its employees a means of facilitating the purchase of annuities, in order to enable them to extend the tax deferred feature of the arrangement past their retirement dates. Those annuities were paid in different monthly amounts for similarly situated men and women. Whether this limited involvement is distinguishable from the open-market purchase of annuities said by the Court in *Manhart* not to violate Title VII we leave to others.

If this Court holds that the *Norris* plan violates Title VII, then the issue of the form of the relief will remain to be decided.

## IV. THE APPROPRIATENESS OF THE RELIEF GRANTED BY THE COURT

The relief granted by the District Court in this case and affirmed by the Court of Appeals directed in part that "annuity payments to female employees who have retired shall be equal to similarly situated male employees." 486 F. Supp. 645, 652 (D. Ariz. 1980). Both courts seemed to contemplate that this relief would be

retroactive, in that it would apply to employees currently receiving benefits. Equality of payments could be achieved, consistent with the contractual obligations of the insurer, only by "topping off"—raising benefits paid under a particular option to the level of the higher paid sex.[26] Such relief has in fact been ordered in *Retired Public Employees* v. *State of California, supra*.[27]

If this Court were to affirm the decision below, and thereby adopt both an equal monthly payments rule and a rule favoring retroactive relief involving "topping off" existing benefits, its decision would apply *a fortiori* to defined contribution and defined benefit plans as well. Because "topping off" requires an increase in benefits unforeseen when the assets that support a plan were

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[26] The annuity payments to both men and women could be adjusted to a point somewhere between the higher monthly amounts previously paid to one and the lower amounts paid to the other—using a mortality table appropriate for the plan and its particular mix of men and women. This form of relief probably could not be implemented, however, because current annuitants have enforceable contractual promises by the insurance company that existing payments will continue to be made. For a similar reason, achieving equality by lowering the levels of monthly payments now made to the favored sex down to the level of the less-favored sex would also be barred.

[27] There, the plan provides equal monthly annuity payments to similarly situated men and women who retire at age 60. Where such employees retire early, however, the women receive slightly higher benefits, and, conversely, in the case of late retirement, the men receive slightly higher benefits. The relief ordered was to increase the payment of all benefits to the level of the most favored employees. This relief was made retroactive to the date of this Court's decision in *Manhart*, requiring a lump sum retroactive adjustment very much like the back pay award that this Court rejected in *Manhart*. But even if the district court's order were effective only from the date of its own decision, the order would still require a change in the benefits of employees who have already retired.

set aside, such relief would in fact require a very large additional infusion of capital into a great number of plans. The impact on individual plans could range from negligible to the point that the continuation of the plan would be brought into doubt. For some plans, this increased burden could result in the termination of the plan. The cost to retirement plans as a group has been estimated at anywhere from in excess of $1 billion to several times that amount annually.

We have noted that employers electing defined contribution plans tend to be those employers (often of rather modest size) for whom it is extremely important to control their pension costs. Retroactive "topping off" relief would wholly frustrate this objective. As to deferred compensation plans such as the plan in this case, the required additional funds could only come from the employer. Yet the very essence of the plan was that it was to be funded wholly out of voluntary contributions by the employees, with the State merely administering the plan. We should note that Arizona responded to the *Norris* decision by simply discontinuing the annuity option.

Should the Court conclude that the Arizona deferred compensation plan is in violation of Title VII, the granting of relief only on a prospective basis avoids the financial consequences described in the previous two paragraphs, and would be consistent with the position taken by this Court in *Manhart*. Because Arizona offered a plan in which it had a limited role, it could reasonably have concluded that its arrangement came within the open market exception articulated in *Manhart*. As this Court said in *Manhart*, "[W]e must recognize that conscientious and intelligent administrators of pension funds, who did not have the benefit of the extensive briefs and arguments presented to us, may well have assumed

that a program like the Department's was entirely lawful." 435 U.S. at 720.[28]

There are several ways prospective relief can be defined. One form of prospective relief would require that the payment of benefits be altered only for employees who retire after the date of the Court's order.[29] The benefits for all employees now still working would be based on unisex factors. If such an order were made, widespread and substantial adjustments of currently anticipated benefits would be required, and the cost of the benefits in many instances would be increased. A less significant impact would result if only benefits that accrued after the date of the Court's order, or benefits based on contributions made after that date, were required to be altered. Under such an order, part of the employees' benefits would be based on unisex factors and part on sex-distinct factors. The least impact would result if the Court's order applied only with respect to employees hired after the date of the order.

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[28] As this Court has previously recognized in fashioning remedies under Title VII that may affect "the expectations of innocent parties," the courts "must 'look to the practical realities and necessities inescapably involved in reconciling competing interests,' in order to determine the 'special blend of what is necessary, what is fair, and what is workable.'" *Teamsters* v. *United States*, 431 U.S. 324, 375 (1977), *quoting Lemon* v. *Kurtzman*, 411 U.S. 192, 200-201.

[29] For some plans (*e.g.*, those that have purchased units of annuity with each contribution), any reduction in benefits might encounter existing contractual obligations to persons not yet retired.

## CONCLUSION

We do not take any position as to how Title VII should be applied in this or in any other case. We recognize that, in resolving the issues presented by this and related cases, the Court must consider a number of factors some of which are not dealt with in this brief and are not matters on which actuaries have particular expertise. We do suggest, however, that the nature and structure of the retirement plans involved and the practical consequences that may result should be relevant to the Court's decision.

Respectfully submitted,

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